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PARIS FOR D'ELIA

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SUBJECT: IMF: MALAWI SCORES SATISFACTORY REVIEW

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SUMMARY

¶1. (U) The IMF's assessment mission has given Malawi passing marks in the second review of its 2005 program. Citing strong fiscal performance, the team predicted that Malawi would reach HIPC completion point at mid year. The team expects fiscal difficulty in the first half of 2006, because of higher than planned expenditures on food and agricultural inputs. The team also noted that while Malawi met all quantitative targets, at least some structural targets were met late. They also faulted Malawi for continued high backlogs of import payments, the result of controlling foreign exchange rates too tightly. End summary.

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¶2. (U) As expected (see reftel), the IMF's second quarterly mission to evaluate Malawi's Poverty Reduction and Growth Facility (PRGF) reported satisfactory performance in its outbrief on 21 March. Team leader Calvin MacDonald said all quantitative benchmarks had been met, as well as most structural benchmarks, though some of the latter had been met late. This successful review, if approved by the board, would give Malawi six months of satisfactory performance under a PRGF--a condition for debt relief under the Highly Indebted Poor Country (HIPC) program and the Multilateral Debt Relief Initiative. MacDonald indicated that the IMF anticipates providing $13 million in debt relief in the second half of CY06 and $20.5 million during CY07.

CHALLENGES: AGRICULTURAL SPENDING AND FOREX

¶3. (SBU) The first half of CY06 does hold some challenges for Malawi. The IMF expects the GOM to have some difficulty meeting its budget numbers in the first half of CY06 (second half of Malawi's FY05/6) because of higher than planned spending on maize and fertilizer imports. (Both of these extra expenditures have been ascribed to the poor 2005 harvest, but there are early signs that the administration may have set itself a pattern for heavy intervention in the fertilizer and maize markets. GOM plans to spend MK5.5 billion ($42 million) on fertilizer next year, compared with MK6.9 billion ($53 million) this year.) And it was clear that the IMF intends to hold Malawi to account for not having adopted a "more flexible" foreign exchange policy. MacDonald said the IMF had agreed on a plan to measure and reduce the import backlog over the rest of the year. (The backlog results from an overvalued kwacha, which has effectively dried up the supply of dollars for private importers.)

¶4. (U) Fiscal year 2006/7, which begins in July, comes with happier prospects. The IMF agrees with the GOM's forecast of 8.5 percent growth, which is a modest figure for a rebound year. With a good harvest, budget pressure should be less, and a good tobacco and tea harvest should help with foreign currency reserves. Inflation is expected to decline gradually to as little as 7 percent by the end of the fiscal year. The GOM projected continued paydown on domestic debt, from 19.7 percent of GDP in FY05/6 to 16.1 percent in FY06/7. While this is behind the program's 19.3 and 15 percent, respectively, it is still a massive improvement from 24 percent in the last fiscal year.

RISKS: WAGES, MANAGEMENT, FOOD SPENDING

¶5. (SBU) The IMF's MacDonald outlined several risks for the

coming year, starting with government pension and wage growth that have resulted from recent reforms. IMF is concerned mainly that the reforms be carefully implemented and monitored to hold to the budget. (Up to now, the reforms can perhaps best be described as spastic, with frequent withdrawals of announced benefits, after-the-fact changes, and catch-up payments to compensate for yawning gaps in the implementation.) In order to have a chance at accomplishing this, the finance ministry will have to strengthen itself considerably.

¶6. (U) Finally, MacDonald suggested that the international community engage with the GOM on food security, to ensure the efficiency and appropriateness of future operations, and on financial management capacity, especially in view of the upcoming HIPC windfall. He said he had asked the GOM to come up with an action plan for public finance reform and hopes for participation from Malawi's development partners. He specifically cited with approval the Millennium Challenge Account Threshold program in this area.

COMMENT

¶7. (SBU) Generally, Embassy agrees with the positive assessment of this IMF review team. Certainly the government has done an admirable job in re-establishing fiscal discipline over the past year and a half. That it has not also institutionalized better financial management is to be expected at this point; institutional reforms are much more difficult and lengthy to effect than quick spending cuts. We agree also with the subtext of MacDonald's suggested interventions for donors: the biggest risks appear to center on the GOM's capacity to make itself more efficient at managing money, and its resolve to avoid a fiscal derailment over food and agriculture giveaways. Policymakers here have a long way to go before they trust the private sector with

the crucial agricultural sector, and running it themselves will be both expensive and counterproductive.
EASTHAM